



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Release to Manager, EO Determinations - Cincinnati

Date:

JUL 10 2002

INTERNAL REVENUE SERVICE
CINCINNATI, OHIO

OCT 28 2002

RECEIVED
TEGE DIVISION

Contact Person: SURNAME [REDACTED]

Identification Number: [REDACTED]

Telephone Number: [REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

This is in reply to your application for recognition of exemption under section 501(c)(3) of the Internal Revenue Code.

You were established in [REDACTED]. Your amended Articles of Incorporation state your purposes as researching, upholding and maintaining domestic and international ethical issues concerning art ownership. This includes restitution and repatriation issues and efforts, and helping to restore the legal rights of the parties involved.

You are basically an endeavor by two individuals, [REDACTED] and [REDACTED]. [REDACTED] is your founder and executive director and president. [REDACTED] is your secretary and acting general counsel. [REDACTED] has general responsibility for all aspects of your research and although [REDACTED] and [REDACTED] are both attorneys, [REDACTED] is your legal counsel.

In your letter of [REDACTED], you indicate that you have not presented any educational programs and that your sole activity has been your involvement in an effort by a certain family to recover a particular work of art for them.

In your letter of [REDACTED], you state that you became involved in this claim after "[f]amily members were found [by you] through arduous research, and lengthy negotiations resulted in an agreement allowing [you] to represent the family's interests." In your [REDACTED] letter you also note that although you do not expect to be compensated by this family for the work you will do for them, you expect that the museum, the defendant in this situation, will repay you for all the expenses you will incur and will compensate [REDACTED] and [REDACTED] for both their hourly commissions and the expenses they will or have incurred in this endeavor. In your letter of [REDACTED], you indicated that you consider an annual salary of \$[REDACTED] reasonable for [REDACTED] and that [REDACTED] bills by the hour at \$[REDACTED] hour.

On [REDACTED], we requested additional information from you to help us determine whether you were operating in a manner similar to a for profit business and whether your income inured to the benefit of your principals. We requested a description of the services provided by your officers and directors to your client and copies of any contracts or other agreements regarding this matter. We also specifically requested a copy of any contracts you

have with [REDACTED] for his services to you and to them. In addition, because your application indicated that you leased your office space for \$[REDACTED] per year, we requested a copy of your lease and an appraisal of the property if you leased it from one of your officers or directors.

In your letter of [REDACTED], in partial response to our inquiry regarding the work you had done, you state the work done by your officers and directors, "is contained in [REDACTED] of files and materials relating to the current claim being process. Records are also kept of the time spent and duties performed on the current claim. There are over [REDACTED] pages of these documents alone, describing research performed, travel required, conversations, letters, memoranda and related matters. My [REDACTED] time spent is estimated to be at least [REDACTED] hours over the past [REDACTED] years. These records contain information that is confidential to the claimant, family members and cannot be divulged without their permission, and then only after confidentiality agreements are in place." You describe your agreement with [REDACTED], as an oral agreement and provided no additional information other than to indicate that all materials regarding his activities are confidential. You did not submit copies of any contracts or otherwise describe the agreements under which your principals are working. You made no representations concerning the reasonableness of the compensation you expected to pay your principals.

As regards your lease, you state that thus far [REDACTED] has donated all the office space and expenses and that at this time providing any other information would "appear to be beyond the scope of this application."

Section 501(c)(3) of the Internal Revenue Code describes organizations organized and operated exclusively for religious, charitable and educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more purposes specified in that section. If an organization does not meet either the organizational or the operational test, it is not exempt

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more of the purposes specified in section 501(c)(3) unless it serves a public rather than a private interest. Thus, to met these requirements, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense. It includes relief of the poor and distressed, the advancement of religion, the advancement of education and lessening the burdens of government.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), Ct.D. 1650, C.B. 1945, 375, the Supreme Court of the United States held that the presence of a nonexempt purpose, if more than insubstantial, would destroy tax exempt status as a charitable organization.

In United States v. Wells Fargo Bank, 485 U.S. 351, 108 S. Ct. 1179, 99 L. Ed. 2d 368 (1988), the Supreme Court held that an organization must prove unambiguously that it qualifies for a tax exemption.

Harding Hospital, Inc. v. United States, 505 F.2d 1068 (1974), holds that an organization seeking a ruling as to recognition of its tax exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute. Whether an organization has satisfied the operational test is a question of fact.

In Old Dominion Box Co. v. United States, 477 F.2d 344 (4th Cir. 1973) cert. denied 413 U.S. 910 (1973), the court held that operating for the benefit of private parties constitutes a substantial non-exempt purpose.

In Spokane Motorcycle Club v. U.S., 222 F. Supp. 151 (1963), the Court indicated that even a small amount of private inurement is fatal to exemption. In that case net profits were found to inure to private individuals where refreshments, goods, and services amounting to \$825 (representing some 8 percent of gross revenues) were furnished to members.

In Birmingham Business College, Inc. 276 F.2d 476 (1960) the Court held that unreasonable compensation is a form of inurement. Those in control of an organization may not withdraw its earnings under the guise of salary payments.

In Texas Trade School, 30 T.C. 642, Aff'd 272 F.2d 168 (1959) the Court found inurement where unreasonable rental charges were being paid to the principals of an organization.

In Beth-El Ministries, Inc. v. U.S., 79-2 USTC 9412 (Ct. Cl., D.C. 1979) the Court denied exemption to an organization because it failed to meet its burden to show that no part of its net earnings inured to the benefit of any of its members who were entitled to receive benefits in the form of food, clothing, shelter, medical care, recreational facilities and education services in exchange for a commitment of donating all possessions and salaries to the organization.

Rev. Rul. 75-74, 1975-1 C.B. 152 holds that a public interest law firm that provides representation in cases it selects as having significant public interest and for which representation by traditional private law firms is not economically feasible is operated exclusively for charitable purposes and qualifies for exemption under section 501(c)(3) of the Code. The ruling emphasized that providing an ordinary commercial service to the members of

[REDACTED]

a community, even if done on a not-for-profit basis, is not regarded as charitable. The key to exemption in public interest litigation is that it is not economically feasible for private firms to handle public interest representation. In the typical public interest case, no individual plaintiff has a sufficient economic interest to warrant his bearing the cost of retaining private counsel.

Rev. Rul. 76-142, 1976-2 C.B. 148, provides that a nonprofit organization whose primary activity is the offering of free legal services for personal tax and estate planning to individuals who wish to make current and deferred gifts to charity as part of their overall tax and estate planning does not qualify for exemption under section 501(c)(3) of the Code. The organization is providing commercially available services to individuals who can afford them. Although funds may ultimately be made available to the public as a result of the planning assistance to individuals, the public benefit was tenuous in view of the predominately private purposes served by arranging individual's tax and estate plans.

Whether an organization has satisfied the operational test is a question of fact. See Harding Hospital, Inc. v. United States, *supra*. The existence of more than an substantial nonexempt purpose will preclude exemption. See Better Business Bureau of Washington, D.C., Inc. v. United States, *supra*. As emphasized by the Supreme Court in United States v. Well Fargo Bank, *supra*, qualification for exemption must be proven unambiguously.

In order to qualify for exemption an organization must serve a public rather than a private interest. See section 1.501(c)(3)-1(d)(1)(ii) of the regulations and Cio Dominion Box Co. v. United States, *supra*. Similarly, the earnings of the organization cannot inure to the benefit of its principals or other individuals in position of authority in the organization. See Spokane Motorcycle Club v. U.S., *supra*. Inurement of income has been found where an organization pays excessive rents or salaries to its principals. See the holdings in Texas Trade School, *supra* and Birmingham Business College, Inc., *supra*.

The information you have submitted indicates that your sole activity, to date, involves the work you have engaged in on behalf of a private party seeking to reclaim possession of a work of art. You obtained information regarding this work of art and then sought out individuals who had a claim to the painting. You negotiated with these individuals and they agreed to have you represent them in negotiations with the third party who was currently in possession of the work of art. You and your principals expect to be fully compensated for the services provided. Although requested, you have refused to submit a more complete description of the specific activities you have carried on, the costs you have incurred or any other information regarding this matter. In addition, you have refused to submit copies of any contracts or other agreements you have entered into regarding this endeavor. You state that you consider all such information confidential. In addition, when questioned about the rent you indicated that you were to pay [REDACTED], you stated that you had not paid any yet and that, if you were to pay such, our request for an appraisal would raise property rights issues that at this time appear to be beyond the scope of this application.

In addition, as a general rule providing ordinary commercial services to the members of a community, even if done on a not-for-profit basis, is not regarded as charitable. The services you provide are similar to the practice of law. You have a client who has a conflict with another party and you entered into negotiations on behalf of your client. You expect to be paid for the

5

services you provide and the costs you incur. Furthermore, your activities, if successful, will apparently benefit your client financially.

Rev. Rul. 75-74, supra, recognizes that in some instances the provision of legal services, is a qualifying charitable activity. However, the revenue ruling stresses that, in order for an organization which is providing such legal services to be considered charitable, the cases being litigated must involve an issue of important public interest, and it must be shown that it is not economically feasible for a commercial law firm to provide services. The economically feasible condition is generally met where it is clear that no private person has a sufficient economic interest in the outcome of the litigation which would justify the retention of private counsel. You have not shown that your activities meet the requirements set forth in this revenue ruling. Furthermore, as recognized in Rev. Rul. 76-422, supra, providing ordinary services to individuals that can afford to pay for such services, even free of charge, may provide private benefit to the recipients that far outweighs any benefit to the public. In the situation described in the revenue ruling, even though there may ultimately be a certain amount of future public benefit such public benefit is tenuous in view of the predominately private purposes served.

By failing to provide us with any contracts or similar information regarding your activities, you have not shown how your program differs from a commercial enterprise. Accordingly, we are unable to conclude that your activities are educational or charitable within the meaning of section 501(c)(3) of the Code.

In addition, by failing to describe your activities or lease arrangement, we are unable to conclude that any payments you will make to your principals are reasonable. It appears that your earnings may inure to the benefit of your officers and directors through the payment of excessive salaries and rents.

Accordingly, we conclude that you do not qualify for recognition of exemption under section 501(c)(3) of the Code. You must file Federal income tax returns and contributions to you are not deductible under section 170.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement, signed by one of your principal officers, must be submitted within 30 days from the date of this letter. You also have the right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your principal officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practice Procedures.

[REDACTED]

If you do not protest this proposed ruling in a timely manner, it will be considered by the Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding unless the United States Tax Court, the U.S. Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

Sincerely yours,

151

Joseph Chasin
Acting Manager,
Exempt Organizations
Technical Group 2